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Before the
COPYRIGHT ROYALTY JUDGES
Washington, D.C.

In the Matter of Distribution of the 2004 and 2005 Cable Royalty Funds	)	Docket No. 2007-3 CRB CD 2004-2005

Testimony of

Robert W. Crandall

June 1, 2009

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I. QUALIFICATIONS

1. My name is Robert W. Crandall. I have been a Senior Fellow in Economic Studies at the Brookings Institution since 1978. Prior to that I was the Acting Director, Deputy Director, and Assistant Director of the Council of Wage and Price Stability in the Executive Office of the President, and between 1974 and 1975 I was an Adviser to Commissioner Glen Robinson of the Federal Communications Commission ("FCC"). I was an Assistant Professor and Associate Professor of Economics at MIT between 1966 and 1974.

2. I have written widely on telecommunications policy, the economics of broadcasting, and the economics of cable television. In 1971 and 1972, I published articles on the FCC financial-interest/syndication rules in *The Journal of Law and Economics* and the *Bell Journal of Economics*. In 1974, I co-authored an article on cable television profitability in *The Journal of Business*. In 1974, I also published an article on the economics of network television in *Public Policy*. In 1978, I published an article on the economic effect of television broadcast regulation in *Regulation*. In 1981, Stanley Besen and I coauthored a paper on cable television regulation that was published in *Law and Contemporary Problems*. In 1990, I conducted a number of empirical studies of the cable television industry that were submitted in various FCC proceedings on behalf of TCI and are incorporated into a chapter in Bruce Owen and Steven Wildman's *Video Economics*, published by Harvard University Press in 1992. I am the co-author of two books released in 1996 by the Brookings Institution: *Talk is Cheap: The Promise of Regulatory Reform in North American Telecommunications* (with Professor Leonard

Waverman) and *Cable TV: Regulation or Competition?* (with former FCC Commissioner Harold Furchtgott-Roth) and the author of *Competition and Chaos: U.S. Telecommunications since the 1996 Telecom Act*, published by the Brookings Institution in 2005.

3. I have served as a consultant to several government agencies and participated in a variety of government advisory panels. Between 1967 and 1968, I was a consultant to the Justice Department on a variety of network television and motion picture issues. Between 1978 and 1979, I served as a consultant to the FCC on the deregulation of signal carriage rules for cable television. I have also served as a consultant to several clients on matters relating to copyright and product licensing issues – including the National Cable Television Association, the three major television broadcast networks, and other cable and broadcast industry clients.

4. I testified before the Copyright Royalty Tribunal on behalf of the Joint Sports Claimants ("JSC") in the 1989 cable royalty distribution proceeding and on behalf of the National Cable Television Association in the 1981 proceeding to adjust cable royalty rates. I also testified before the Copyright Arbitration Royalty Panel on behalf of JSC in the 1990-92 and 1998-99 cable royalty distribution proceedings.

5. I am offering this testimony on behalf of JSC in my individual capacity and not as an employee of the Brookings Institution, which does not take institutional positions with respect to specific legislation, litigation, or regulatory proceedings.

6. A copy of my curriculum vitae is attached as Appendix A.

II. INTRODUCTION AND SUMMARY

7. In this testimony, I conclude that:

- The copyright royalties paid by cable systems to import distant broadcast signals should be allocated as they would have been allocated by marketplace transactions.
- The best evidence on how the marketplace would have allocated these royalties is to be found in constant sum surveys of cable system executives who are asked how they would have allocated a fixed budget for imported distant broadcast signals.

III. THE COPYRIGHT ROYALTY JUDGES SHOULD ALLOCATE THE 2004-05 CABLE ROYALTY FUNDS AS THEY WOULD HAVE BEEN ALLOCATED IN A MARKET.

8. Typically, a copyright holder of non-network programming on a broadcast television station is directly compensated by that station for the use of the copyrighted programming at a rate negotiated between the station and the copyright holder. The broadcast station generates revenues from broadcasting the copyrighted programming through advertising inserted in the programs. When a cable system retransmits a "distant" broadcast station's[1] signal over its facilities, the programming on that broadcast station becomes available to a larger audience than otherwise. Because the retransmitted signal contains the programming of many different copyright holders, Congress thought that there would be large transaction costs if the cable system operator had to negotiate individually with each of these numerous copyright holders for the rights to offer all of the programs offered over that signal.

9. Accordingly, Congress established compulsory licensing as a substitute for arms-length transactions between cable systems and individual copyright holders of

[1] A distant broadcast station, in general, is a station that is not located in the cable system's television market and whose carriage was not mandated under the FCC's 1976 or current "must carry" rules.

distant-signal programming.[2] The terms of the compulsory license are set by statute. The resulting license fees paid by cable systems are collected by the Copyright Office in a cable royalty fund to be distributed to the copyright owners whose "non-network"[3] programming has been retransmitted on distant broadcast signals.

10. Congress initially gave the authority to distribute these royalties to the Copyright Royalty Tribunal ("CRT"). The CRT was replaced with the Copyright Arbitration Royalty Panel ("CARP"), which in turn was replaced by the current Copyright Royalty Judge system for royalty distribution.

11. The CRT and CARP concluded that the allocation of royalties must be based on how copyright holders would have been compensated in a market environment.[4] Thus, in the last litigated proceeding (covering the royalty years 1998 and 1999), the CARP concluded that "one distribution criterion appears to have stood the 'test of time' and has served as the principal basis for allocating cable copyright royalties -- 'relative marketplace value.'"[5] In other words, the CARP's "primary objective is to 'simulate [relative] market valuation' as if no compulsory license existed."[6] It then proceeded to analyze a hypothetical marketplace in which "absent a compulsory license, the distant

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2 Copyright Act of 1976, Pub. L. No. 94-553 § 111, 90 Stat. 2541 (1976).

3 A "non-network" broadcast signal is the signal of a broadcast station that is not affiliated with the major television networks ABC, CBS and NBC. My understanding is that Fox is not considered a network for purposes of Section 111.

4 *Nat'l Ass'n of Broadcasters v. Copyright Royalty Tribunal*, 772 F.2d 922, 939 (D.C. Cir. 1985) (CRT "should rely, as it has in the past, on marketplace criteria"); Report of the Copyright Royalty Tribunal in Docket No. CRT 79-1, 45 Fed. Reg. 63,026, 63,037 (Sept. 23, 1980) (compulsory license should not deprive any copyright owner of "relative copyright payment [it] would have received in a free marketplace"); Report of the Copyright Arbitration Royalty Panel in Docket No. 94-3 CARP CD 90-92 at 23-24 (May 31, 1996) (hereinafter, "1990-92 CARP Report").

5 Report of the Copyright Arbitration Royalty Panel in Docket No. 2001-08 CD 98-99 at 9 (Oct. 21, 2003) (hereinafter, "1998-99 CARP Report").

6 *Id.* at 10.

signal retransmission market would not be fundamentally different than under the compulsory license."[7]

12. From an economist's perspective, using a market valuation approach is the appropriate way to determine the royalty shares that should be awarded to each of the claimants. Congress intended the compulsory license to be a more efficient way of compensating copyright owners by eliminating the transaction costs that would result from direct negotiations between cable systems and all of the copyright owners of programming retransmitted on distant signals.[8] I am not aware of any evidence that Congress, through the compulsory license, intended to change the relative distributions that any claimant group would have received in a market. Although the statute does not set forth specific criteria governing how the royalty fund should be divided among the various programming categories, the CRT and CARP conclusions that distributions should approximate relative market value make economic sense because they replicate the hypothetical market value of the copyrights used.[9] Such a division of the royalty fund preserves as much as possible the free-market incentives that would otherwise exist for copyright holders to create content and permit its use over-the-air.

IV. THE BORTZ CONSTANT SUM SURVEY IS AN APPROPRIATE MEASURE OF THE RELATIVE VALUE OF DISTANT SIGNAL PROGRAMMING

13. In a competitive environment, a market transaction would compensate a copyright holder according to the copyrighted program's marginal contribution to cable-

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[7] *Id.* at 12.

[8] "The Committee recognizes, however, that it would be impractical and unduly burdensome to require every cable system to negotiate with every copyright owner whose work was retransmitted by a cable system. Accordingly, the Committee has determined to . . . establish a compulsory copyright license . . . ." H.R. Rep. No. 94-1476, 89 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5704.

[9] I have discussed this point in more detail in my testimony in prior proceedings. *See* Testimony of Robert W. Crandall (1990-92 Proceeding) (JSC 04-05 Ex. 5 at 7).

system net revenues. In other words, the cable operator would be willing to buy rights to the programming directly or indirectly from the copyright holder according to how much additional revenue the cable operator would generate by retransmitting the copyrighted programming.

14. Determining this "market value" for specific types of programming is difficult. The compulsory license requires the cable operator to pay a minimum royalty every six months even if no programming is retransmitted over that period. Moreover, the cable operator may not insert commercials or otherwise modify the distant signal. As a result, it is almost impossible to determine the precise marginal contribution to a cable system of a specific copyright holder's programming on a distant signal. Therefore, one must look for other evidence to estimate a hypothetical market between copyright holders and cable system operators.

15. The parties in the Phase I proceedings have generally advocated using one of two competing methodologies for determining marketplace value of retransmitted programming: constant sum surveys of cable system managers and household viewing studies.[10] Constant sum surveys ask cable system managers to allocate a percentage of a hypothetical programming budget for the non-network distant signals that they carry to each of the various programming categories – sports, movies, syndicated television series, devotional programs, public television programming, Canadian programming and locally-originated broadcast programming. Household viewing studies use data collected

[10] Various regression analyses have also been offered from time-to-time in these proceedings, including by the JSC in the 1979 proceeding, Program Suppliers in the 1990-92 proceeding and by the Commercial Television claimants in the 1998-99 proceeding. The 1998-99 CARP noted that the regression analysis presented in that proceeding was useful in that it provided some corroboration of the results of the Bortz survey. 1998-99 CARP Report at 50.

by A.C. Nielsen to estimate the number of hours that households watch each program category.

16. As I have explained in earlier proceedings, the constant sum survey is the best tool to answer the question presented in this proceeding. In my testimony for the 1989 proceeding, I explained the economic theory underlying assessments of relative market value and discussed how the constant sum survey – the "Bortz survey" – was the best evidence of those values. *See* Testimony of Robert W. Crandall (JSC 04-05 Ex. 6 at 9-14). In the 1998-99 proceeding, I explained again the value of the Bortz survey data in showing relative market value and discussed why earlier criticisms of the survey were not well-founded. *See* Testimony of Robert W. Crandall (JSC 04-05 Ex. 5).

17. As I also have discussed in my prior testimony, over time, the CRT and the CARP relied increasingly (and properly) on the constant sum surveys of cable executives, the Bortz survey and its predecessors, as the best estimate of relative marketplace value of the copyrighted programming imported by cable systems.[11] *See* JSC 04-05 Ex. 5. In the latest CARP decision, the Panel decided that "the Bortz survey is more reliable than any other methodology presented in this proceeding for determining the relative marketplace value of [the JSC, Program Suppliers and Commercial Television] claimant groups."[12]

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[11] The CARP considered but rejected the Nielsen viewing study sponsored by the Program Suppliers in the 1998-99 proceeding finding that it "does not afford an independent basis for determining relative value." 1998-99 CARP Report at 44. The CARP explained that because the Nielsen Study "'fails to measure the value of the retransmitted programming in terms of its ability to attract and retain subscribers,' it can not be used to measure directly relative value to [cable system operators]." *Id.* at 38. As I have testified in prior proceedings, this conclusion is consistent with my own views of the Nielsen study. *See* Testimony of Robert W. Crandall (1990-92 Proceeding) (JSC 04-05 Ex. 7); (1989 Proceeding) (JSC 04-05 Ex. 6 at 15-18).

[12] 1998-99 CARP Report at 31. The Panel also found that the Bortz results would serve as a "floor" for determining the relative marketplace value of PTV and that the Canadians were not sufficiently represented in that survey. *Id.* The Panel resolved the Canadians' share by relying in part on a

18. The advantage of the constant sum survey is that it attempts to measure the relative value that cable system operators place on various program categories. Since these operators would make the program purchasing decisions in the marketplace that would exist but for the compulsory copyright license, this type of survey provides the best information on the operation of the hypothetical marketplace in the absence of actual data on programming purchases, which do not exist. The Bortz survey has been conducted for over 25 years in connection with these proceedings and, over that time, has been refined and improved to respond to various criticisms.[13] In my opinion, it is a robust and reliable instrument with a significant track record.[14]

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separate constant sum survey conducted by the Canadians. The Panel did not reach the question of application of the Bortz results to determine the Devotionals' share because they had settled. *Id.* at 72-73.

[13] For a detailed history of the use of constant sum surveys in previous proceedings, see Section II.A of the Bortz Report (JSC 04-05 Ex. 1 at 10-11).

[14] The 1989 CRT, 1990-92 CARP and 1998-99 CARP reports discuss the various witnesses who have supported the Bortz survey during those proceedings. *See* Report of the Copyright Royalty Tribunal in Docket No. CRT 91-2-89CD, 57 Fed. Reg. 15,286, 15,292-95 (Apr. 27, 1992); 1990-92 CARP Report at 45-54; and 1998-99 CARP Report at 19-31, respectively. Economists who have supported the Bortz survey over the various proceedings include Vanderbilt University economist Dr. David Scheffman (1990-92; testifying on rebuttal for PTV) (JSC 04-05 Ex. 8 at 21-23); Boston University economist Dr. Michael Salinger (1990-92; testifying for Devotionals) (JSC 04-05 Ex. 9 at 6-10); and valuation expert Paul Much (1990-92; testifying for CTV) (JSC 04-05 Ex. 10 at 2-6).

I declare under the penalty of perjury that the foregoing is true and correct to the best of my knowledge and belief.

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May 29, 2009
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Competition and Chaos: U.S. Telecommunications since the 1996 Act. Washington, DC: The Brookings Institution, 2005.

Broadband: Should We Regulate High-Speed Internet Access? (edited with James Alleman), AEI Brookings Joint Center for Regulatory Studies, 2002.

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Certificate of Service

I hereby certify that on Monday, February 12, 2018 I provided a true and correct copy of the Robert Crandall Written Direct Testimony (JSC Written Direct Statement Vol. II) to the following:

Public Broadcasting Service (PBS), represented by Lindsey L. Tonsager served via Electronic Service at ltonsager@cov.com

National Association of Broadcasters (NAB), represented by Ann Mace served via Electronic Service at amace@crowell.com

Broadcast Music, Inc. (BMI), represented by Brian A Coleman served via Electronic Service at Brian.Coleman@dbr.com

American Society of Composers, Authors and Publishers (ASCAP), represented by Sam Mosenkis served via Electronic Service at smosenkis@ascap.com

Multigroup Claimants, represented by Brian D Boydston served via Electronic Service at brianb@ix.netcom.com

Spanish Language Producers, represented by Brian D Boydston served via Electronic Service at brianb@ix.netcom.com

SESAC, Inc., represented by Christos P Badavas served via Electronic Service at cbadavas@sesac.com

Canadian Claimants Group, represented by Victor J Cosentino served via Electronic Service at victor.cosentino@larsongaston.com

National Public Radio, Inc. (NPR), represented by Gregory A Lewis served via Electronic Service at glewis@npr.org

Devotional Claimants, represented by Michael A Warley served via Electronic Service at michael.warley@pillsburylaw.com

MPAA-represented Program Suppliers, represented by Lucy H Plovnick served via Electronic Service at lhp@msk.com

Signed: /s/ Michael E Kientzle